

Daily Market Strategy

Tuesday, 20th October 2009

Market Strategy

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- GBP/gilts braced for governor King speech
- Nymex crude tops \$80, equities to extend gains

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6419, €/\$: 1.4969, \$/¥: 90.19

UK 5y sw: 3.28%, US 5y sw: 2.73%, EU 5y sw: 2.81%

Overnight

- RBA minutes: "low rates no longer needed, possibly imprudent"
- Strong Q3 earnings from Apple and Texas Instruments
- US Oct homebuilding confidence drops as first-time homebuyer tax credit expires
- German Sep PPI falls 0.5% m/m (-7.6% y/y), bigger than expected drop

A combination of stellar US earnings and hawkish RBA minutes boosted risk appetite overnight and caused the US dollar index to fall below 75.20. Nymex crude topped \$80 for the first time in a year and gold looks set to test the previous high at \$1,070. Sticking to a defensive posture for rates/swaps is prudent in this context. BoE governor King takes to the stage today but his scheduled speaking time of 20:15 means market reaction will have to wait until tomorrow morning. Speeches by the governor on a Tuesday prior to release of MPC minutes the following day have some history and could result in below average trading volumes today. Many will remember the governor's Mansion House engagement of March 17th which triggered a 450 pip trading range on the 18th for GBP/USD (225 pips in EUR/GBP) and a 16bp move in Dec-09 short sterling. This argues for a cautious approach.

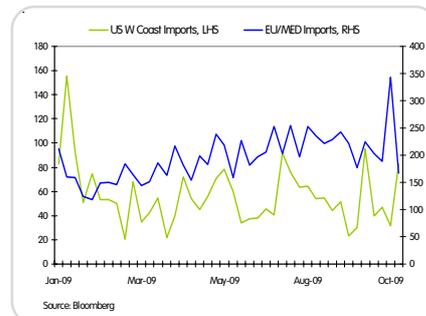
Ahead today: US Sep PPI and housing starts/building permits will be followed by a speech by FOMC voter Warsh (hawk). The Bank of Canada is expected to keep its overnight lending rate at 0.25%. A word-for-word repeat of the September statement could clear the path to parity for USD/CAD, so we would not exclude a more forceful warning against CAD strength as the Bank targets durable economic recovery.

FX: Option structures stand in the way of EUR/USD breaking 1.50 but with equities and high yielding currencies marching higher, we think a break is just a matter of time - despite Trichef's best efforts to slow EUR gains. The Bank of Canada could play a prominent role this afternoon for CAD crosses as outlined above. Support in USD/CAD runs at 1.0275.

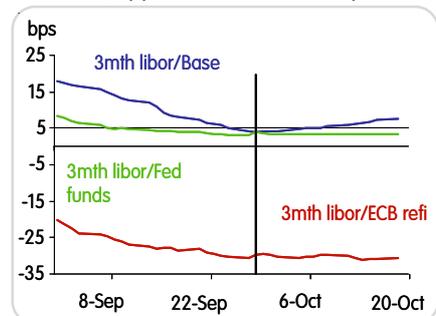
Rates: Ranges were observed overnight, with UK 5y swaps opening near yesterday's close at 3.28%. BoE governor King's speech tonight will come too late to influence gilts and short sterling futures, leaving dealers to eyeball M4 money supply and US PPI/housing stats instead. We stick to the view that rates are not out of the woods and see danger of a back up in 5y swaps towards 3.37% resistance, especially with stronger retail sales looming on Thursday. Support is holding firm at 3.27%. The BoE will purchase £1.4bn gilts today in the long and ultra-long 2036 to 2055 maturities.

	Close	Daily Change
FX		%
EUR/GBP	0.9110	-0.02%
GBP/USD	1.6421	0.40%
EUR/USD	1.4965	0.40%
USD/JPY	90.550	-0.38%
AUD/USD	0.9292	1.39%
Bonds %		bp
US 10Yr	3.389	-2.2
EUR 10Yr	3.301	1.5
UK10 Yr	3.599	3.0
UK 5yr Swap	3.275	0.5
Equities		%
S&P500	1097.91	0.94%
FTSE100	5281.54	1.76%
Eurostoxx50	2947.41	1.86%
Shanghai Composite	3070.00	1.04%
Commodities		%
Crude Oil \$/bl	79.61	1.38%
Gold \$/oz	1064.2	1.01%
Copper	296.7	4.25%
Baltic Dry	2766	1.39%
Other		
VIX	21.49	0.28%
iTraxx XOVER	505.24	-15.6

Container imports in the EU/Med have dropped sharply into October



UK libor/base rate spread has started to widen, opposed to EU and US spreads



Today's Events

German PPI, Sep
UK PSNCR, Sep
UK PSNB, Sep
UK M4, Sep prelim
Japan Tertiary Industry Index, Aug
US PPI, Sep
US PPI Core, Sep
US Housing Starts, Sep
US Building Permits, Sep
Canada Leading Indicators, Sep
Bank of Canada Rate Decision

Time	Consensus	Previous
07:00	-0.5% A	+0.5%
09:30	+£19.0bn	+£10.4bn
09:30	+£15.5bn	+£16.1bn
09:30	+0.5%	+0.1%
00:50	+0.3%	+0.7% R
13:30	+0.1%	+1.7%
13:30	+0.1%	+0.2%
13:30	0.610m n	0.598m n
13:30	0.590m n	0.579m n
13:30	+0.7%	+1.1%
14:00	0.25%	0.25%

BoE speakers: governor King (20:15)
Fed speakers: Warsh (16:00)
EU Ecofin meeting, day two
RBA publishes minutes of October rate meeting
BoE to buy £1.4bn of gilts: UKT_4.25_070336, UKT_4.75_071238, UKT_4.25_070939, UKT_4.5_071242, UKT_4.25_071246, UKT_4.25_071249, UKT_4.25_071255
Earnings: BNY Mellon, Coca-Cola, Caterpillar, Pfizer, Yahoo

- Right on cue, the equity markets continued their upward trend yesterday with the S&P cash touching 1,100 (1,106 is the closest significant resistance) and the Dow putting a decent margin of 92 points above the 10,000 level. FTSE futures edged into contract highs at 5,255, but should extend sharply to the upside today with 5,400 the next objective. The market seems keen to run with this bullish theme and with Shanghai stocks up another 1.00% overnight (through the resistance point mentioned yesterday at 3,070), there seems to be positives wherever you look. With the VIX remaining heavy at 21.50 and looking to push lower as well as crude oil hitting \$80, the risk-on attitude looks set to burn for a while longer. However, there is a risk that the market is getting slightly carried away here. Some of these technical levels have been long term targets and the market is bound to look bullish when we arrive. For now, the outlook is positive, but I still view this in the context of a bear market rally.
- The main themes continue in the FX markets with the USD broadly weak. The market continues to choose the EM and commodity currencies (note the PLN is close to a major level at 2.7743) to express this view, but this still gives scope for GBP and the EUR to extend gains. A continued rally for cable is expected here with 1.6450 the target level mentioned yesterday. A break opens the door to 1.6750, which is the preferred view technically. This should also see EUR/GBP lower (downside targets revised to 0.8800) and GBP/JPY extend through 150. If the trends result in commodity currencies becoming over-bought, there is an argument for switching into sterling against these currencies as the pound has had its weakness discounted, implying the risk is for broad strength. DXY support at 75.15 is important from a fibonacci and price action perspective (76.40% retracement from the March 08 low to the March 09 high). But despite this, the downtrend dominates and, as gold prepares for another rally through \$1,070, dollar weakness continues.

Chart of the day: Crude Oil extends higher \$81.00 is the target.

Key Levels



	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.5287	1.6743	95.15	0.9520	1.1135
R1	1.4966	1.6455	91.74	0.9482	1.1018
Current Spot	1.4888	1.6310	90.85	0.9128	1.0955
S1	1.4845	1.6125	87.14	0.9076	1.0546
S2	1.4407	1.5709	85.00	0.8981	1.0504

Spot prices as of: 07:14:05 Source: Bloomberg

Crude oil technical target has been at \$81.00 for year end. Clearly this is very close, hence this will be revised up to \$90.00. Note natural gas futures should also break \$6.000, from a 'H&S' reversal.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4888	Bullish	1.4650	1.5287	1.4765	Stop raised, break of 1.4969 key.
USD/JPY	90.85	Bullish	90.50	94.00	89.40	91.74 key resistance.
USD/CHF	1.0189	Bearish	1.0360	1.0000	1.0260	
GBP/USD	1.6310	Bullish	1.6125	1.6750	1.5930	Pennant formation is bullish- 1.545 resistance is key- then 1.6743.
EUR/GBP	0.9128	Bearish	0.9311	0.9000	0.9175	Stop moved down.
GBP/JPY	148.18	Bullish	143.71	153.27	146.10	Stop raised.
EUR/JPY	135.27	Bullish	<u>134.00</u>	138.74	133.65	
CAD/JPY	87.52	Bullish	87.20	92.00	86.30	
AUD/USD	0.9184	Bullish	0.8888	0.9291	0.9175	Stop hit.
USD/CAD	1.0381	Neutral	1.0650	1.0000	1.0375	USD short covered- consider re-selling against 1.0550.
NZD/USD	0.7452	Bullish	0.7360	0.7600	0.7415	Stop hit.
USD/BRL	1.7101	Bearish	1.8338	1.7000	1.7175	Stop hit. Sell USD at 1.7300.
USD/PLN	2.8256	Bearish	2.8100	2.7000	2.8230	Stop hit. Sell at 2.8400.
USD/HUF	179.37	Bearish	179.20	175.00	180.65	

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

US equities have pushed higher, with the S&P500 probing 1,100, as companies continue to provide upward surprises in their Q3 earnings and Q4 outlook reports. Results by Texas Instruments and Apple (released after the equity markets closed) have left equity futures supported overnight.

The correlation between equities and commodities continues to build – the 1-month correlation between the S&P500 and the CRB has risen to 0.85 (from 0 at the start of September). The correlation table also suggests that this environment is extremely negative for the USD, which overnight has recorded a marginal new low for the year. Hence, it is not surprising that in the G-10 space, commodity currencies have opened the week strongest. With a lack of forward looking data until Friday (when the EZ flash PMIs are released), we look for this theme to hold as corporate earnings reports maintain their momentum.

Interest rate spreads (our analysis is based on 2-year interest rate swaps) provide another pillar of USD weakness. Spreads, especially in AU-US and NZ-US, are continuing to widen, signalling the potential for further USD selling.

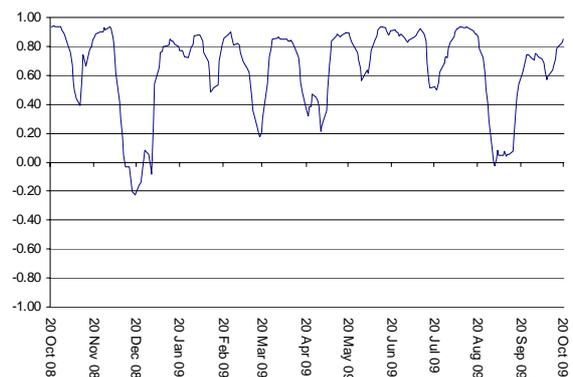
The US PPI report should have little effect on financial markets as it has been preceded by last week's CPI data. Hence, the focus in the US today is likely to be on the housing starts and building permits data. A stronger than expected outturn should help to maintain the bullish sentiment in financial markets.

Our in-house trend following model has not initiated any new positions this morning. The model continues to be positioned short of USD. Across emerging market currencies, it is short USD against all traded currencies (see table below). In developed markets, the model has one exception, in the form of USD/JPY. The recent consolidation in price action, and fast nature of the underlying trend following engine, has resulted in a long position.

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY	AUDJPY
2 YR SPD	0.95	0.93	0.77	0.52	0.62	0.76	0.93
10 YR SPD	0.66	0.70	-0.55	0.26	0.62	0.71	0.90
S&P500	0.80	-0.81	0.91	0.54	0.23	0.72	0.91
Gold	0.94	-0.96	0.82	0.18	-0.29	0.30	0.84
Oil	0.87	-0.88	0.86	0.54	0.08	0.59	0.92
CRB	0.94	-0.93	0.92	0.50	0.02	0.58	0.97

Chart 1: 1-month rolling correlation between S&P500 and CRB index



Trend following model signals

Trend Following Model Positions			
	Signal	Date	Entry Level
AUDUSD	long	15-Sep-09	0.8622
NZDUSD	long	10-Jul-09	0.6298
EURUSD	long	09-Sep-09	1.4480
GBPUSD	long	16-Jan-09	1.6270
USDCHF	short	17-Jul-09	1.0730
USDCAD	short	07-Oct-09	1.0593
USDSEK	short	09-Sep-09	7.0444
USDNOK	short	21-Jul-09	6.3025
USDJPY	long	16-Oct-09	90.55
Net-USD portfolio position			-78%

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	short	19-May-09	19.709
USDPLN	short	15-Oct-09	2.8237
USDSGD	short	08-Sep-09	1.4337
USDTRY	short	15-Sep-09	1.4939
USDZAR	short	31-Aug-09	7.7525
Net-USD portfolio position			-100%

Market Summary

	Close	Daily Change %		Close	Daily Change %
FX			Equities		
EUR/USD	1.4965	0.40%	S&P500	1097.91	0.94%
USD/JPY	90.55	-0.38%	DJIA	10092.19	0.96%
AUD/USD	0.9292	1.39%	FTSE100	5281.54	1.76%
EUR/GBP	0.9110	-0.02%	Eurostoxx50	2947.41	1.86%
GBP/EUR	1.0973	0.00%	Shanghai Composite*	3070.16	1.05%
GBP/USD	1.6421	0.40%	*latest price		
GBP/JPY	148.69	0.01%	Commodities		
GBP/CHF	1.6608	-0.28%	Crude Oil \$/bl	79.61	1.38%
GBP/AUD	1.7671	-0.98%	Gold \$/oz	1064.2	1.01%
GBP/CAD	1.6888	-0.42%	Copper c/lb	296.7	4.25%
GBP/NZD	2.1699	-1.66%	Silver \$/oz	17.84	2.12%
GBP/NOK	9.1251	-0.56%	Baltic Dry	2766	1.39%
GBP/ZAR	11.9754	-0.39%	Swaps %		
GBP/CNY	11.2088	0.38%	US 5yr	2.717	-2.2
Bonds %			EUR 5yr	2.794	0.5
		bp	UK 5yr	3.275	0.5
US 10Yr	3.389	-2.2	Official Rates %		
EUR 10Yr	3.301	1.5	UK	0.50	
UK10 Yr	3.599	3.0	US	0.25	
Other			EU	1.00	
VIX	21.49	0.28%	Japan	0.10	
iTraxx XOVER	505.24	-15.6			
DJ Agriculture Index	63.20	1.73%			

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